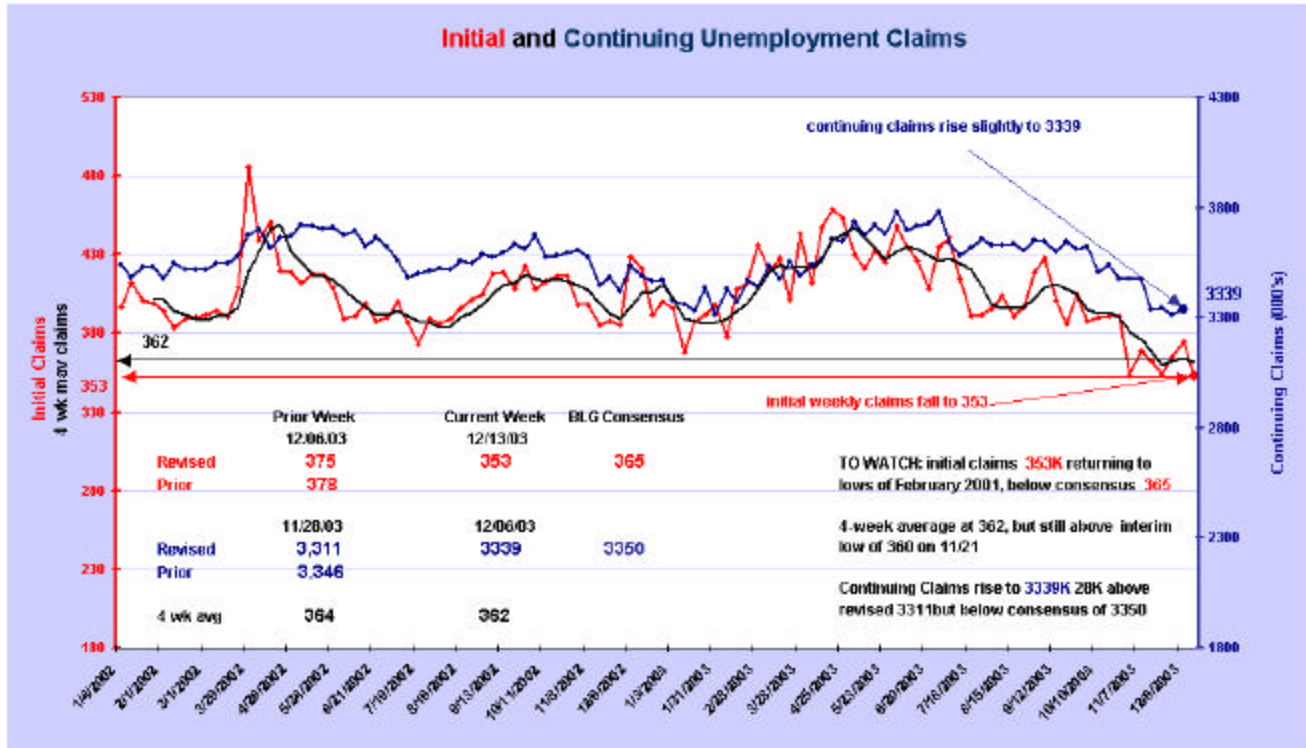




**DATA REVIEW: Initial Claims Fall, Continuing Claims Rise**  
**Yield Curve Flattening**



The broad picture of labor market improvement, as illustrated by the 4-week average falling to 362,000, continued with initial claims falling to 353,000, below a consensus estimate of 365,000 in spite of a rise in continuing claims to 3,339,000. The continuing claims figure represents a 28,000 rise over a revised level of 3,311,000 that had been revised downward from 3,346,000. Continual revisions in these series direct our attention more to the broader picture conveyed graphically above and to multi-week averages that iron out some of the week-to-week data kinks.

**Leading Indicators**

The November LEI came in with a consensus 0.3% rise. Not much new in this compilation except that the recent trend confirms the clear turn upward in the economy with lengthening work weeks and new orders continuing to buttress the recovery of production and labor incomes

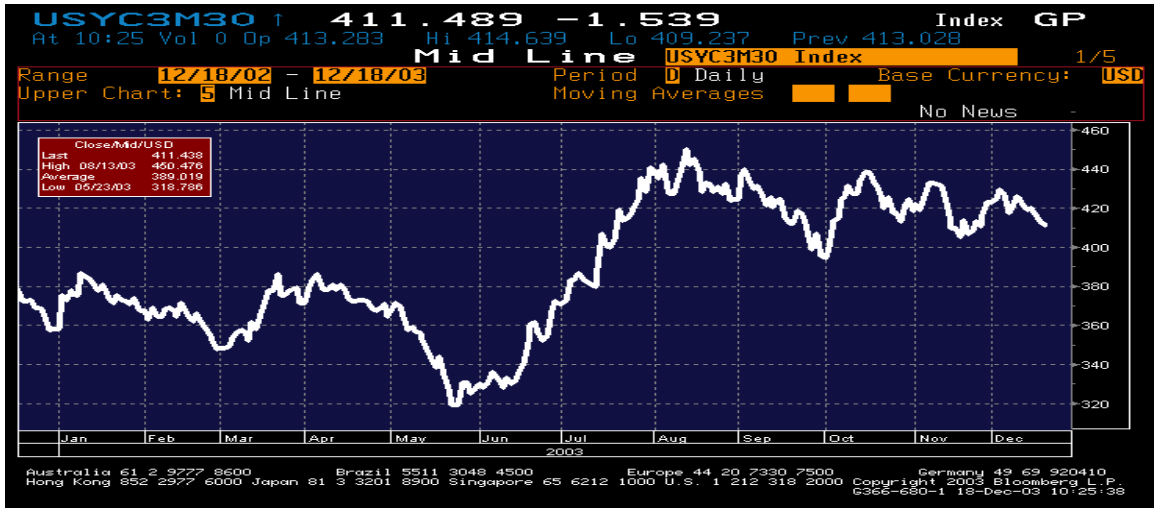
**Will the Carry Spread Weaken?**

The new theme among some forecasters is that the inflation news is so positive as to create some incentives

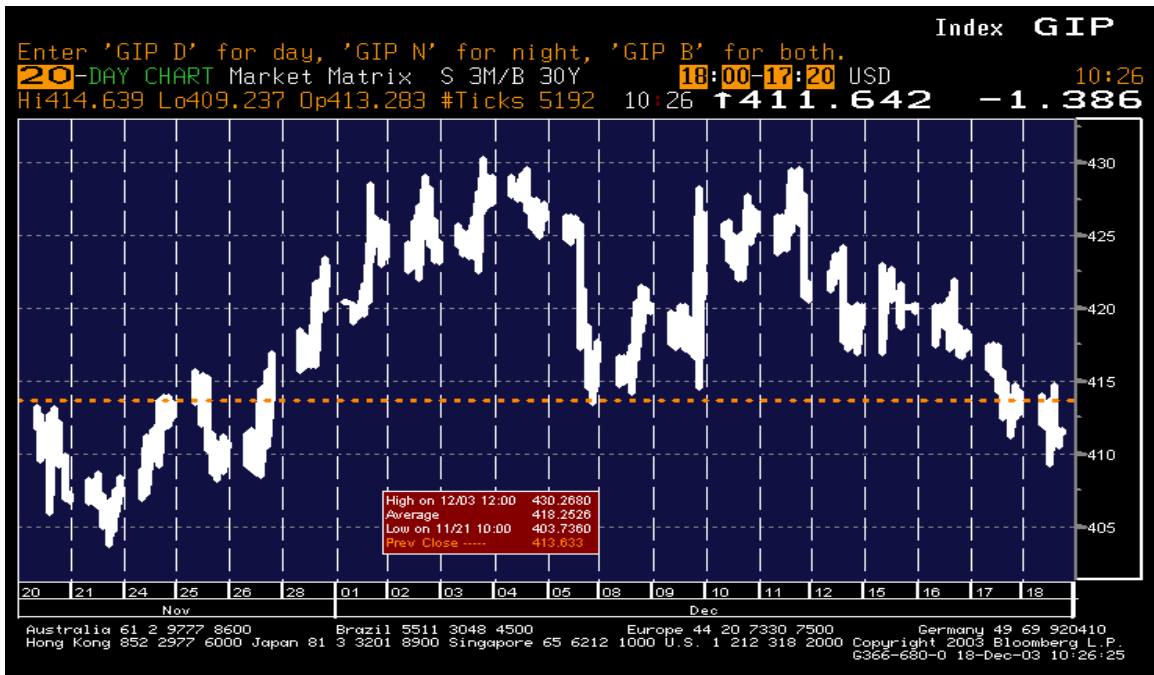


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for the yield curve to flatten with potential for a re-ignition of a burst of “refi” if this tendency were to continue. With the 30 year bond breaking through the 5% mark this morning, curve flattening that has been apparent the past two weeks is accentuated. The incentives for the carry trade, while still large, are diminishing. A further continuation of this trend could trigger more re-fi and some rethinking as to 2004 GDP growth.



Sell 1 Month Buy 30 Year—One Year Chart



Sell 1 Month Buy 30 Year—20 Day Chart



**Sell 2 Year Buy 10 Year One Year Chart**

The flattening of the yield curve can also be seen in the 2-10 spreads. The interesting question is whether the very positive inflation news (deflation again?) will force these spreads close to their levels in May and early June before the collapse in Bond Market expectations that followed the Fed's implicit denial that it would use "unconventional" means to root out the deflation threat.

Since the stutter-start of summer, the economy now seems on a much firmer track, particularly after the outsized GDP performance in QIII 2003. Indications that QIV 2003 GDP would be quite restrained seem to be falling away as the indicators of business optimism and hiring improve. The sharp decline in CPI inflation seems to have awakened the Bond Market to the possibility that the economy will experience continued reductions in inflation and that yields will need to adjust accordingly. Similar tendencies seem apparent throughout the curve beyond the 'tethered' Federal Funds-30 day range.

With the 30 year bond breaking through the 5% mark this morning, the curve flattening that has been apparent the past two weeks is accentuated. The incentives for the carry trade, while still large, are diminishing. A further continuation of this trend and a trigger to re-fi will cause some rethinking as to Q1 2004 as well as 2004 GDP as a whole.